

# ANALYSIS OF ORIGINAL BILL

## Franchise Tax Board

Author: Chan & Vargas Analyst: Rachel Coco Bill Number: AB 6  
Related Bills: See Legislative History Telephone: 845-4328 Introduced Date: December 6, 2004  
Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** PIT Rates/Increase Maximum Rates To 10% & 11%/AMT Rate To 8.5%

### SUMMARY

This bill would increase the top personal income tax (PIT) rates to 10% and 11% and would increase the alternative minimum tax (AMT) rate to 8.5%. This bill also would reduce the amount of tax paid under the increased tax rates by the amount of tax imposed under Proposition 63, as explained below under "This Bill."

### PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to protect education funding and vital health and safety services.

### EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2005, and before January 1, 2010.

### POSITION

Pending.

### Summary of Suggested Amendments

Amendment 1 is provided to correct a misspelling.

### ANALYSIS

#### FEDERAL/STATE LAW

Federal law imposes five different income tax rates on individuals ranging from 10% to 35%. Existing state law imposes six different PIT rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income known as a "tax bracket." Existing state law requires the Franchise Tax Board (FTB) to recalculate the tax brackets each year based on the change in the California Consumer Price Index.

#### Board Position:

_____ S	_____ NA	_____ NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	<u>  X  </u> PENDING

#### Department Director

#### Date

Will Bush

1/14/05

Federal law provides a personal income AMT rate of 26%. Existing state law provides a personal income AMT rate of 7%. A taxpayer with substantial income can use preferential tax benefits, such as exclusions, deductions, and credits, to reduce their income tax liability. AMT was established to ensure that a taxpayer who can use preferential tax benefits does not completely escape taxation.

Proposition 63 was approved by voters in the November 2004 General Election and provides a dedicated funding source for the expansion of mental health treatment options for children, adults, and seniors, as follows:

- Starting with the 2005 taxable year, it imposes an additional 1% tax, not subject to reduction by credits, on the portion of a taxpayer's taxable income that exceeds \$1 million.
- The estimated revenue from the additional 1% tax is deposited into the Mental Health Services (MHS) fund on a monthly basis, subject to an annual adjustment.

### THIS BILL

This bill would establish a PIT rate of 10% for:

- Single filers (including married filing separate) whose taxable income is over \$142,582 and equal to or less than \$285,164,
- Joint filers whose taxable income is over \$285,164 and equal to or less than \$570,327, and
- Head of household filers whose taxable income is over \$194,075 and equal to or less than \$388,151.

This bill would establish a PIT rate of 11% for:

- Single filers (including married filing separate) whose taxable income is over \$285,164,
- Joint filers whose taxable income is over \$570,327, and
- Head of household filers whose taxable income is over \$388,151.

For example:

#### 2004 Tax Brackets And Rates For Single Filers

\$0	-	\$6,147	1.0%
\$6,147	-	\$14,571	2.0%
\$14,574	-	\$22,997	4.0%
\$22,997	-	\$31,925	6.0%
\$31,925	-	\$40,346	8.0%
\$40,346	-	And Over	9.3%

#### 2005 Tax Brackets And Rates For Single Filers As Proposed

\$0	-	\$6,147	1.0%
\$6,147	-	\$14,571	2.0%
\$14,574	-	\$22,997	4.0%
\$22,997	-	\$31,925	6.0%
\$31,925	-	\$40,346	8.0%
\$40,346	-	\$142,582	9.3%
\$142,582	-	\$285,164	10%
\$285,164	-	And over	11%

Note: The 2005 tax bracket amounts are not known at this time due to the annual indexing adjustment, which is based on data that is not available until the end of June 2005.

This bill provides that the 10% and 11% brackets would be adjusted annually for inflation.

This bill also would increase the AMT rate to 8.5% for individual taxpayers.

This bill specifies that the amount of tax imposed under the increased tax rates shall be reduced on a dollar-for-dollar basis by an amount equal to the tax imposed under Proposition 63. For example, a taxpayer whose taxable income is \$1.5 million would be subject to a tax of \$5,000 under Proposition 63, to be deposited into the MHS fund. Under this bill, the \$5,000 of tax imposed under Proposition 63 would be subtracted from the amount of the taxpayer's total tax liability. Because the tax imposed under Proposition 63 is deposited into the MHS fund rather than the General Fund, the revenue increase from the 10% & 11% tax rates is less than if Proposition 63 had not been enacted.

### IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

### **LEGISLATIVE HISTORY**

Proposition 63, enacted during the November 2, 2004, general election, imposes an additional tax of 1% of the amount of a taxpayer's taxable income that is over \$1 million, and precludes any reduction in this tax by any otherwise allowable credits.

AB 4 (Chan, 2003) and SB 1255 (Burton, 2002) contained language similar to the language of this bill. Both bills failed to pass out of the house of origin by the constitutional deadline.

SB 169 (Alquist, Stats. 1991, Ch. 117) increased the tax rates on individuals for taxable years beginning on or after January 1, 1991, and before January 1, 1996, by adding 10% and 11% brackets and increasing the AMT rate from 7% to 8.5%.

### **PROGRAM BACKGROUND**

In the early 1990s, California faced a severe recession, which resulted in significant shortfalls in the state budget. In response, the state acted to increase revenues and reduce expenditures. As one way of increasing revenues, the state imposed a temporary income tax rate increase in 1991, adding 10% and 11% rates for the highest income taxpayers. This temporary tax increase was in effect for four taxable years and sunset for taxable years beginning on or after January 1, 1996.

### **OTHER STATES' INFORMATION**

The states surveyed include *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* does not have a personal income tax. *Illinois*, *Massachusetts*, and *Michigan* impose a flat tax. *Minnesota* has a progressive rate with a maximum tax bracket of \$63,860 and a maximum tax rate of 7.85%. These amounts and rates apply to the 2004 taxable year.

*New York* recently added two additional tax rates, which increased the maximum rate from 6.85% to 7.5% and 7.7%. These additional tax rates are effective for taxable years 2003 through 2005. For taxable years beginning after 2005, the rates would revert back to a maximum of 6.85%.

## **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## **ECONOMIC IMPACT**

### Revenue Estimate

This bill would result in the following revenue gain:

Estimated Revenue Impact of AB 6 Taxable Years Beginning On Or After January 1, 2005 Assumed Enactment After June 30, 2005 (\$ Billions)		
2005-06	2006-07	2007-08
+\$3.4	+\$2.7	+\$2.8

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

### Revenue Discussion

The above estimate is based on the department's personal income tax model and is estimated to impact approximately 360,000 taxpayers. This estimate should be considered preliminary because an updated personal income tax model will not be available until February.

## **LEGISLATIVE STAFF CONTACT**

Rachel Coco  
Franchise Tax Board  
845-4328  
[rachel.coco@ftb.ca.gov](mailto:rachel.coco@ftb.ca.gov)

Brian Putler  
Franchise Tax Board  
845-6333  
[brian.putler@ftb.ca.gov](mailto:brian.putler@ftb.ca.gov)

Analyst	Rachel Coco
Telephone #	845-4328
Attorney	Patrick Kusiak

FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 6  
As Introduced December 6, 2004

AMENDMENT 1

On page 8, line 1 strikeout "some" and insert:

same